Yankee Institute Policy Brief

A Fresh Start: Governor Malloy's 2017 Budget Revisions

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Overview

- Lawmakers adopted a preliminary 2017 budget last year when they wrote the current two-year budget. Gov. Malloy recently proposed $570 million in cuts to next year's state budget.
- The cuts represent a 5.75 percent decrease in spending across all state agencies, but do not include funds for Education Cost Sharing, state employee pay and benefits, and debt service.
- The cuts, if passed, will likely mean over a thousand fewer state jobs.
- Even with these cuts, there is still a $700 million projected deficit in FY 2018, the first year of the next budget.
- "Fixed" costs are increasing faster than revenues can keep up – for example debt service is up 13 percent; Medicaid spending is up 5 percent; and retired state employee health care costs are up 9.5 percent.
- Gov. Malloy's new approach to budgeting should be applauded, and the legislature should be encouraged to follow his lead.
- Gov. Malloy should listen to Republican proposals to reform state employee benefits, and should insist that the full legislature vote on state employee contracts.

Budgets Past and Present

Twenty-five years ago, then-Gov. Lowell Weicker announced that he wanted the state of Connecticut to have an income tax, that the income tax would be the answer to Connecticut's budget problems. He was facing a large budget hole, and said he saw no other way out. The income tax was supposed to create a new and consistent stream of revenue for the state so that it no longer faced devastating deficits budget cycle after budget cycle.[1]

Clearly, the income tax did not resolve Connecticut's budget issues.

Connecticut used to be the low-tax alternative to states like New York and Massachusetts in the Northeast. But now, especially after the two largest tax increases in the state's history in just four short years, Connecticut's taxes are on par or higher than all of its neighbors. Losing that advantage has damaged our competitiveness, and we are now reaping the results of those policy decisions – devastating deficits budget cycle after budget cycle. The problem the income tax was intended to "fix" has only worsened -- and created severe, lasting damage in its wake.

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[1] Weicker, Lowell. Budget address, Feb. 13, 1991. Found at: http://www.yankeeinstitute.org/2016/02/weicker-feel-good-speech-income-tax/

Five Principles

This year, Gov. Malloy is promising something different. In this year's State of the State address, he laid out five principles that he says will guide how he budgets for the rest of his tenure:

1. Limit spending to available resources.
2. Address the state's long-term unfunded obligations.
3. Prioritize funding for core services.
4. Hold state agencies accountable for their results.
5. Reform the budgeting process.[2]

These are sound principles, and the Yankee Institute applauds the governor's adoption of them -- not least because all were laid out in our 2014 document, "Roadmap to Renewal."[3]

But the big question is whether Gov. Malloy will stick to these new principles, and not fall back on past practices by raising taxes again. The people of Connecticut are understandably wary, given that this is the same administration that implemented the two largest tax increases in state history – both of which had disastrous consequences for the state.

However, if Gov. Malloy stands strong in defending the principles he has articulated and his budget is adopted as it stands, Connecticut will face a much brighter future. This budget represents a meaningful change: It represents a decision to turn to responsible and accountable fiscal management of the state.

Let's hope that the legislative leadership will also see the necessity of this change of course and will likewise choose to also act in a fiscally responsible manner.

The Process

Connecticut works on a two-year budget cycle. A 'fiscal year' runs from July 1 through June 30. The legislature passed the 2016-2017 state budget last June. We are now in the middle of fiscal year 2016, which runs from July 1, 2015 to June 30, 2016. This year, the governor is proposing revisions to the fiscal year 2017 budget.

The state budget is created through a partnership between the governor and the legislature. First the governor proposes the budget, and then it goes through both

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[2] Malloy, Dannel. 2016 State of the State Address. Feb. 3, 2016. Found at: http://portal.ct.gov/Departments_and_Agencies/Office_of_the_Governor/Press_Room/Speeches/Governor_Dannel_P__Malloy_s_2016_State_of_the_State_Address/

[3] Bates, Suzanne. Roadmap to Renewal. Yankee Institute, Oct. 8, 2014. http://www.yankeeinstitute.org/2014/10/roadmap-to-renewal-policy-solutions-to-revitalize-connecticut/

the Appropriations and the Finance Committees in the legislature. The Appropriations Committee decides how the money in the budget should be spent; and the Finance committee decides how to pay for the commitments Appropriation makes. In Connecticut, the Appropriations Committee goes first – so the legislature first decides how much it wants to spend and then it figures out how to raise that money from taxpayers.

After going through the committee process, the budget must be voted on by the House and Senate. Finally, it ends up back on the governor's desk for a signature. In addition to the budget, the legislature also votes on an "implementer" bill, which usually does not go through the committee process. The implementer bill is supposed to literally implement the budget – or give permission for all of the spending in the budget. In actuality, the implementer is often stuffed full of many other legislative proposals and includes much more than the details of the budget.

The Budget Revisions

Gov. Malloy's 2016-17 budget proposal, which he first pitched in February 2015, included $800 million in new taxes and delayed tax cuts. By the time the legislature finished it, the budget called for $1.8 billion in higher taxes. The tax hikes hit private enterprise the hardest, and led prominent business leaders from several corporations – including GE – to oppose the budget.

As some predicted, even the second largest tax hike in state history failed to close the budget hole, as tax collections continue to come in below projections. In December, the legislature met to make emergency cuts of $350 million from the budget. That was enough to close the hole in the 2016 budget, but not enough to close the deficit in the 2017 budget.

The deficit is largely a function of the growth in 'fixed' costs – especially for state employee pay and benefits -- while tax revenue growth remains almost flat. Some of those major cost drivers include:

- Payments for interest and principal on bonded debt - up 13 percent.
- Medicaid spending - up 5 percent.
- Spending on retired state employee health care - up 9.5 percent.
- Current state employee health care costs - up 7.2 percent.

To close the 2017 budget deficit, Gov. Malloy has proposed $118 million in specific cuts, and another $361 million through a 5.75 percent across the board reduction in discretionary spending in each agency.[4] The budget also changes the way money is allocated by moving to a block grant system instead of a line-by-line funding of

[4] Malloy, Dannel. Slide presentation of 2017 midterm budget adjustments. Feb. 3, 2016. Found at: http://www.ct.gov/opm/lib/opm/budget/2017midterm/budget/fy17budgetpresentation.pdf

programs. Several lawmakers have already said they oppose this change, as they say it transfers their budgeting authority to agency heads.

In addition to cutting funds, the budget also:

- Caps probate fees on estates at $40,000.
- Creates a $10,000 personal property tax exemption for businesses.
- Eliminates minimum bottle pricing on alcoholic beverages.

Gov. Malloy's spending cuts will likely lead to a reduction in the state's workforce. But if state employees were willing to pay more for their pension and health care benefits some of those jobs could likely be saved.

Don't Forget the Spending Cap

In his State of the State address, Gov. Malloy called for the legislature to fully implement the constitutional spending cap. The cap, which was approved by over 80 percent of voters in 1992, was never fully implemented by the legislature because they failed to define key terms.

In his address, Gov. Malloy said, "It's time we give them what they asked for. The wisdom of the voters was correct in 1992, and it is correct now. Connecticut needs to enact a spending cap to keep spending in check."

Although we wish Gov. Malloy would have come to this realization six years ago, we are pleased he is now supporting the implementation of the spending cap and hope he will continue to provide leadership on this issue.

The Dark Cloud: State Debt

Even with these new austerity measures, the state still faces an uphill climb back to fiscal sustainability. That is because the state carries a significant amount of debt.

According to the Economic Report of the Governor, the state government debt at the end of FY 2013 was $32.4 billion, up from $30.5 billion just two years earlier. That represents a per capita government debt of $8,991, while the 50 state average was $3,590.[5]

The state also has significant pension and retiree healthcare debt. The latest state Comprehensive Annual Financial Report shows the state has $26.3 billion in pension debt and another $22 billion in debt to the retiree health care fund. Connecticut has the third-worst funded state employee pension fund in the nation, and the pension

[5] Economic Report of the Governor FY 2017 Midterm, p. 4. Found at: http://www.ct.gov/opm/lib/opm/budget/2017midterm/budget/economicreportofthegovernorfy2017midterm.pdf

debt crisis (documented by the Yankee Institute in its August 2014 study "Born Broke") continues to represent a serious stumbling block to the state's fiscal future.

Looking Ahead

Beyond 2017, budget deficits continue to loom on the horizon. This will likely mean additional cuts will be necessary to balance the budget in the future.

Much depends on whether Gov. Malloy is serious about his budget principles. They are sound -- and, if followed, represent a good start to get the state back on track.

Finally, if fiscal sustainability is truly the governor's goal, he will listen to his colleagues on the other side of the aisle, and will make lasting changes to the way the state sets its state employee benefits. Those benefits should be set legislatively, and they should be more in line with the benefits that workers in the private sector receive.

For the Malloy administration, this is a time for choosing. The road ahead may not be easy -- but the governor has an opportunity: To make the choices that could mark a turning point in Connecticut's climb back to prosperity.